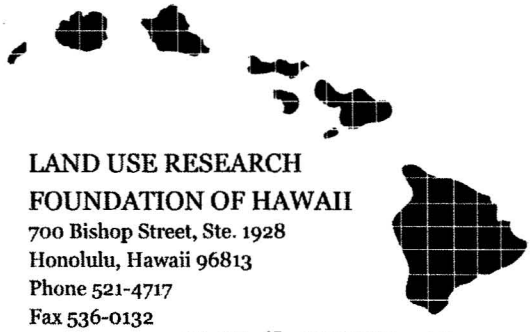
LATE TESTIMONY



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February 2, 2010

Opposition to HB 2284 Relating to Real Property
(Sunset date extension re Act 189 - Alteration of commercial lease renegotiation terms)

Honorable Chair Angus K. McKelvey, Vice Chair Isaac W. Choy, and
Member of the Committee on Economic Revitalization, Business & Military Affairs

My name is Dave Arakawa, and I am the Executive Director of the Land Use Research Foundation of Hawaii (LURF), a private, non-profit research and trade association whose members include major Hawaii landowners, developers and a utility company. One of LURF's missions is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources and public health and safety.

LURF strongly opposes HB 2284, and respectfully requests that this Committee **hold HB 2284, because this measure would extend Act 189, which interferes with the terms of existing contracts, and such alteration of commercial and industrial contracts is unconstitutional, special legislation targeted at one landowner.** Our objections are based on, among other things, the following:

- The stated purpose for Act 189 is not legally justifiable, and the purported intent and purpose(to "stabilize the State's economy," "during the recessionary period," by "preserving the proximity of small businesses to urban communities") is a "pretext."
- Act 189 fails to meet the legal tests of under the Contracts Clause, and is thus an unconstitutional violation of the United States Constitution.
- Act 189 is a "special law" targeted against a single land owner (HRPT Properties Trust), which violates Article XI, section 5 of the Hawaii Constitution. It is also not responsible and prudent public policy to pass a state-wide 'special law' because of a dispute between one lessor and a group of lessees.
- It is unfair to change the terms of existing contracts to favor one party, and thereby alter historical precedent in defining "fair and reasonable annual rent" in HRPT's prior lease negotiations.
- There is no need for this legislation – current lessees are going through the renegotiation process as provided in the existing contracts.

- Other remedies and less intrusive means to achieve public purposes exist – "Don't legislate, just arbitrate."
- Legislation similar to Act 189, which altered lease terms to the benefit of lessees and to the detriment of lessors, has been found to be unconstitutional by the Attorney General.

Act 189 (2009): LURF understands that Act 189 was proposed by lessees who claim they are having trouble negotiating their leases with one lessor - HRPT. Act 189 alters the existing terms of HRPT leases by inserting a new definition of "fair and reasonable annual rent." HRPT, which is the sole target of Act 189, has filed a federal lawsuit challenging the constitutionality of Act 189 (HRPT Properties Trust, *et al.*, v. Linda Lingle, in her capacity as Governor of the State of Hawaii, Civil No. 09-0375). We a hope that the federal court case and/or further negotiations, arbitration and mediation can resolve such differences and result in renegotiated leases which can be accepted by both parties.

HB 2284. Act 189 is supposed to sunset on June 30, 2010. This bill, however, proposes to extend that sunset date for five years, to June 30, 2015; provided that the repeal of this Act shall not affect renegotiations of any lease or sublease rental amount, the renegotiation date for which occurred before July 1, 2015; provided further that this Act shall not apply to any lease scheduled for renegotiation after June 30, 2015.

LURF'S OBJECTIONS. LURF **opposes HB 2284 and the extension of Act 189,** based on, among other things, the following:

- **The stated purpose for Act 189 is not legally justifiable.** Under the circumstances, "stabilizing Hawaii's economy by maintaining close geographic ties between small businesses and the communities they serve" is not a justifiable valid public purpose which would justify altering the terms of existing lease contracts. There is no credible evidence that changing the terms of contracts will assure that small businesses stay close to their customers, or that small businesses will fail if they move to another location – this unconstitutional law cannot be "fixed" by merely stating an illogical "purpose and intent" for the bill, without credible facts supporting it. The purported intent and purpose, which is to "stabilize the State's economy," "during the recessionary period," by "preserving the proximity of small businesses to urban communities" **is a "pretext"** (alleged reason, ploy, ruse, red herring, bogus).
  - Is there any "proof" or evidence to support the stated purpose for Act 189? Or, is the stated purpose mere pretext?
  - How many leases will this law effect? The testimony confirms that affect of Act 189 will be limited to the leases with one lessor – HRPT. How will affecting only HRPT leases assure the proximity of small businesses to the urban communities they serve and stabilize the entire State's economy?
  - If that alleged purpose of supporting small businesses were really true, why does the law only apply to leases with one lessor, HRPT?
  - If Act 189 was an attempt to stabilize the economy by changing the terms of lease negotiations - shouldn't the law apply to the terms of all of the existing business leases in the state? Instead, this bill is meant to affect the lease negotiations with only one lessor, HRPT.
  - If the alleged purpose is to truly help lessees, "especially during the recessionary period"- - **Why does this bill extend Act 189 for five**

years, until June 30, 2015? Is there any evidence that the "recession" will last 5 years?

- **Act 189 fails to meet the legal tests under the Contracts Clause, and is thus is an unconstitutional violation of the United States Constitution.** We believe that in the current Federal court challenge, the provisions of Act 189 will fail to meet the legal test to determine whether a statute is constitutional under the Contracts Clause, as set forth in the Hawaii Supreme Court case of Applications of Herrick & Irish, 82 Haw. 329, 922 P.2d 942 (1996) and quoted by the Attorney General in its prior opinions relating to other bills which have attempted to alter existing lease terms to benefit lessees:

  > "In deciding whether a state law has violated the federal constitutional prohibition against impairments of contracts, U.S. Const., art I, § 10, cl.1, we must assay the following three criteria:
  >
  > 1) Whether the state law operated as a substantial impairment of a contractual relationship;
  > 2) Whether the state law was designed to promote a significant and legitimate public purpose; and
  > 3) Whether the state law was a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose."

  Act 189 cannot be justified under any of these legal tests. As the facts prove:
  - It substantially impairs the contractual relationship between the lessor and lessee;
  - It is not designed to promote a significant and legitimate public purpose; and
  - It is not a reasonable and narrowly-drawn means of promoting a significant and legitimate public purpose.

- **Act 189 is a "special law" targeted against a single land owner (HRPT Properties Trust), which violates Article XI, section 5 of the Hawaii Constitution.** The proponents private real estate attorney and witnesses who supported Act 189 admitted that the lease alterations in the bill are directed only to one lessor, – HRPT. According to the testimony, there is no other landowner who include the terms "fair and reasonable" in their leases. The proponents' paid legal witness claimed that in the future, there could be other leases which include the terms "fair and reasonable" in their rent renegotiation clauses, however, this is clearly a "class of one" because legislators, the proponents' private real estate attorney, and witnesses in support and in opposition to the bill have all stated that if this legislation passes, no other landowner would be foolish enough to include the term "fair and reasonable" in their leases. Thus, Act 189 is a **"special law,"** which is prohibited by the Hawaii Constitution, because it applies to one particular lease renegotiation provision in the leases of just one particular lessor - HRPT, discriminates against one particular lessor - HRPT, and operates in favor of certain lessees, by granting them a special or exclusive privilege. The proponents of this bill and the Governor have admitted that Act 189 was intended to target HRPT, and there is no testimony or evidence regarding any other lessors in the state who utilize the lease renegotiation language which is the subject of Act 189.

- **It is also not responsible and prudent public policy to pass a state-wide 'special law' because of a dispute between one lessor and a group of lessees.** How many state-wide leases are affected? Does a dispute with one lessor warrant a new state-wide law purporting to save Hawaii's economy? We also understand that the proponents have reportedly testified that Act 189 is being used as "leverage" in their lease negotiations with HRPT.

- **It is unfair to change the terms of existing contracts to favor one party, and thereby alter historical precedent in defining "fair and reasonable annual rent" in HRPT's prior lease negotiations.** With respect to Act 189, the targeted lessor, HRPT, has submitted testimony and evidence confirming that this legislation would alter historical precedent in defining "fair and reasonable annual rent" in HRPT's prior lease negotiations. The evidence presented proves that in prior lease negotiations, the term "fair and reasonable" has been defined as "land value multiplied by rate of return" in the following cases: Mapunapuna lease (1997), Pahounui lease (1998) and Moanalua lease (2000).

- **There is no need for this legislation – current lessees are going through the renegotiation process as provided in the existing contracts.** The written and oral testimony at the various committee hearings on Act 189 confirm that HRPT has successfully renegotiated a mutually acceptable rent rate in dozens of leases which have been up for renegotiation.

- **Other remedies and less intrusive means to achieve public purposes exist – "Don't legislate, just arbitrate."** Instead of creating a new law that alters only HRPT's current lease contracts, the disgruntled lessors should just use the existing rights and remedies in their lease contracts – arbitration, or they could request inexpensive mediation. The written and oral testimony relating to Act 189 confirms that HRPT has always accepted lessees' requests for arbitration and mediation.

- **Legislation similar to Act 189, which altered lease terms to the benefit of lessees and to the detriment of lessors, has been found to be unconstitutional by the Attorney General.** Over the past several years, legislation similar to Act 189 has been introduced with the recurring theme of legislatively altering the terms and conditions of existing leases to the benefit of lessees and to the detriment of lessors:
    - In 2008, HB 1075 proposed virtually identical alterations of existing lease contracts to favor the lessee, however, the Senate Economic Development and Tourism Committee (EDT) held the bill. EDT later placed the contents of HB 1075 into HB 2040, SD2, however that bill was held in Conference Committee.
    - In 2007, SB 1252 and SB 1619, proposed virtually identical alterations of existing lease contract to favor the lessee;
    - In 2006, SB 2043, would have imposed a surcharge tax on the value of improvements to real property subject to reversion in a lease of commercial or industrial property;
    - In 2000, SB 873 SD 1, .D 2 also attempted to alter existing lease contract terms to the detriment of lessors and to the benefit of lessees by

proposing to alter existing lease terms to require a lessor to purchase a lessee's improvements at the expiration of the lease term. The Department of Attorney General opined that SB 873, SD 1, HD 2 violated the Contracts Clause (Article I, Section 10) of the U.S. Constitution as follows: "SB 873, as presently worded, will substantially impair existing leases without furthering any apparent public purpose... [It is] unlikely that SB 873 will be found to be a 'reasonable and narrowly-drawn means of promoting... [A] significant and legitimate public purpose." Governor Cayetano relied on the Attorney General's opinion, and vetoed SB 873, SD 1, HD 1.

- In 2001, in response to HB 1131, HD 1, yet another bill which proposed to alter existing lease contracts to favor lessees, the Attorney General again reaffirmed its opinion that the proposed bill violated the Contracts Clause of the U.S. Constitution.
- In 1987, in the Hawaii Supreme Court case of Anthony v. Kualoa Ranch, 69 Haw. 112, 736 P.2d 55 (1987), the Court ruled that a statute requiring a lessor to purchase a lessee's improvements at the expiration of the lease term violated the Contracts Clause. The Court observed that:

  "This statute, as applied to leases already in effect, purely and simply, is an attempt by the legislature to change contractual remedies and obligations, to the detriment of all lessors and to the benefit of all lessees, without relation to the purposes of the leasehold conversion act; without the limitations as to leaseholds subject thereto contained in the conversion provisions; not in the exercise of the eminent domain power; but simply for the purpose of doing equity, as the legislature saw it. If there is any meaning at all to the contract clause, it prohibits the application of HRS §516-70 to leases existing at the time of the 1975 amendment. Accordingly, that section, as applied to leases existing at the time of the adoption of the 1975 amendment, is declared unconstitutional."

CONCLUSION. The intent and application of Act 189, and proposed HB 2284, which intends to extend Act 189, are unconstitutional, profoundly anti-business and bad public policy, and therefore we respectfully request that **HB 2284be held in this Committee.**

Thank you for the opportunity to express our **opposition to HB 2284**.

Property Management & Leasing
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LATE TESTIMONY

February 1, 2010

Representative Angus L.K. McKelvey, Chair
Representative Isaac W. Choy, Vice Chair
House Committee on Economic Revitalization, Business, & Military Affairs

Tuesday, February 2, 2010 at 8:30 a.m.
State Capitol, Conference Room 312

RE: HB 2284 - Relating to Real Property

Chair McKelvey, Vice Chair Choy and Members of the Committee:

My name is Jan Yokota, Vice President of the Pacific Region for Reit Management & Research LLC, the property manager for HRPT Properties Trust ("HRPT"). Through its affiliated companies, HRPT owns industrial zoned land in Māpunapuna and Sand Island and in the James Campbell Industrial Park, and, as landlord, leases many of its Hawai'i properties pursuant to long-term leases which provide for the periodic reset of rent to the then "fair and reasonable" rate.

H.B. 2284 proposes to amend Act 189, Session Laws of Hawai'i 2009, by extending its repeal date from June 30, 2010 to June 30, 2015. As you know, the purpose of Act 189 is to define by statute the meaning of the term "fair and reasonable" in HRPT's leases.

HRPT respectfully, but strongly, opposes H.B. 2284. HRPT has consistently testified before the Hawai'i State Legislature that actions that seek to change legal contracts, such as Act 189, are unconstitutional. Act 189 violates the Contracts Clause of the U.S. Constitution and is unfair to HRPT for the following reasons:

- Act 189 was targeted at (and continues to target) a single landowner—HRPT, changing the agreed upon terms of previously negotiated long-term commercial and industrial lease contracts, for the sole benefit of a small group of lessees. A state statute violates the Contracts Clause of the U.S. Constitution if the state law:
    - Substantially impairs an existing contractual relationship;
    - Does not have a "significant and legitimate public purpose"; and

- Is without a reasonable and narrowly drawn relationship between the impaired contract and the claimed public purpose.

- Under federal law governing Hawai'i, an impairment of a contract is substantial if, among other things, it alters a financial term or deprives a private party of an important right.

  - Act 189 materially affects the most essential term in a commercial and industrial lease: the lessee's obligation to pay rent.
  - Act 189 re-defines an existing term in an existing contract and would command appraisers and courts to interpret the existing term under this new legislation, contrary to the intent of the original lessor, Damon Estate.
  - As Governor Lingle admitted when she allowed the bill to become law without her signature, the purpose of the Act was to "change the process for renegotiating the amount of rent during the term of an existing commercial or industrial lease" and "this bill impacts the negotiations of lease rent..."

- There is no significant and legitimate public purpose for the Act. The stated purpose of Act 189 is to "maintain close geographic ties between small businesses and the communities they serve" and thereby "stabilize Hawai'i's economy." As the Attorney General advised the Legislature last year, there is no support for the proposition that altering HRPT's contractual rights for the benefit of a few lessees will keep small businesses close to urban communities and that this will, in turn, stabilize Hawai'i's economy. The Act is also targeted at, and impacts, a single landowner and a small number of HRPT's lessees.

In August 2009, HRPT filed a lawsuit in U.S. District Court challenging the constitutionality of Act 189. The case was assigned to Judge Susan Oki Mollway. On December 7, 2009, Judge Mollway held a hearing on the case.

At the hearing in federal court on December 7, 2009, Judge Mollway expressed concern "to the extent there's a change in the bargain that is caused by the passage of a statute because it interprets a term in a way different from what the parties intended at the time of the contract." Judge Mollway stated on the record: "If there is a change, then there may well be numerous constitutional problems with this statute."

In mid-December, Judge Mollway issued an order in which she denied the requests from all parties for summary judgment and instructed the parties to conduct further discovery. The discovery process is ongoing and it is expected that Judge Mollway will issue a final ruling on the matter after this process is concluded.

I would also like to take this opportunity to address concerns that have been raised in prior testimony.

- One of the concerns expressed by testifiers is that HRPT's rent reset proposals include "step-ups" and that such "step-ups" are highly unusual. Actually, Damon Estate did negotiate periodic rent step-ups in a number of their leases. In addition, several Māpunapuna and Sand Island lessees have entered into subleases with third parties that include annual step-ups. The Campbell leases provide for annual rent increases based on the Consumer Price Index.
- Another concern mentioned was that our proposals have a "take it or leave it" provision. This is not the case. We begin rental discussions with our tenants well before the reset date and always attempt first to resolve our rental rates through negotiation. In the past few months, we have come to agreement on lease rent without going through the arbitration process with nine of our tenants, including four tenants with leases that include the term "fair and reasonable rent." However, if the parties do not agree, there is an arbitration mechanism in the leases to address a stalemate. In the Servco situation, for example, arbitration was initiated by Servco. Servco's appraiser proposed a rent of $3.65 per square foot and our appraiser proposed a rent of $6.38 per square foot. The three member panel of appraisers set the rent at $5.26 per square foot which was more than half the difference in our favor. The process worked and we can now move forward.
- With respect to the flooding issue in Māpunapuna, we have spent over $750,000 for engineering studies that have resulted in a remedy to resolve the tidal flooding problem. After years of research and planning, the first phase of drainage system improvements is anticipated to commence within three to six weeks, pending final approval of the State of Hawai'i Department of Health. The project should be completed within two to three weeks of commencement and we anticipate that most or all of the daily tidal flooding will cease.

In closing, we respectfully request that the Committee hold this bill given the pending litigation and the serious questions regarding Act 189's constitutionality.

Thank you for the opportunity to testify on this bill.

LATE TESTIMONY

SERVCO PACIFIC INC.
2850 Pukoloa Street • Suite 300 • Honolulu, Hawaii 96819 • Telephone: (808) 594-1300 • Facsimile: (808) 523-3937 • www.servco.com

February 1, 2010

To: The Honorable Angus L.K. McKelvey, Chair
The Honorable Isaac W. Choy, Vice-Chair
and Committee Members
House Committee on Economic Revitalization, Business & Military Affairs

From: Carol K. Lam (B)
Senior Vice President
Servco Pacific Inc.
2850 Pukoloa Street, Suite 300
Honolulu, Hawaii 96819

Hearing Date: Tuesday, February 2, 2010, 8:30 a.m.
Conference Room 312/State Capitol

In Support of House Bill 2284, Relating to Real Property

On behalf of Servco Pacific Inc. ("***Servco***"), I submit the following comments in support of the adoption of HB 2284 (the "***Bill***").

Servco recently completed a ground rent arbitration with HRPT for Servco's 10-acre site in Mapunapuna. The hearing lasted one-week, and both Servco and HRPT fully presented their views on rent. That arbitration panel unanimously decided on a rent of $5.26/SF for the 10-year period beginning February 2009 ***with no step ups or annual increases***.

We understand that since that arbitration award was announced, HRPT has continued to insist on *both* a first year rent that is well in excess of the Servco award *and* on 3% to 4% annual rent increases.

We support the passage of HB 2284 to remind HRPT that it needs to set rents that are fair and reasonable to both the Lessor and Lessee.

We thank you for the opportunity to share our comments with you.

LATE TESTIMONY

PLYWOOD HAWAII

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Honolulu, Hawaii 96819
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February 1, 2010

Representative Angus L.K. McKelvey, Chair
Representative Isaac W. Choy, Vice-Chair
House Committee on Economic Revitalization, Business, & Military Affairs
State Capitol
Honolulu, Hawaii 96813

Re: HB 2284 Re: Relating to Real Property – **Testimony in Support**
Hearing Date: Tuesday, February 2, 2010, 8:30 AM, Room 312

Dear Representatives McKelvey, Choy and Members of the Committee:

I am writing in support of HB 2284 to extend the provisions of Act 189 for another five years. Our company faces renegotiation of rent in July of this year, one month after the expiration of Act 189. We advised our landlord of our intention to exercise our first 5 year option in June of 2009, and received a reply this month asking for a new lease rate of $7.00 per foot per year plus a 3% annual increase. Our current rate is $3.87 with no step-ups. The letter advised that we had three weeks to accept the offer or settle through arbitration means. No offer to negotiate was included in the letter.

We are a small family-owned business that employs 11 people. Our current base rent is $120,000 per year. The new rent would increase to a total of $216,713 per year in the first 12 months following the increase and would increase to nearly $244,000 in year five.

As you can imagine, arbitration is an expensive alternative, particularly in a year impacted so heavily by the economic downturn. The current situation is a "take it or leave it" choice, leaving those who want to remain at their location little alternative but to bear the heavy costs of the arbitration panel, attorneys and appraisers to set a reasonable rent. Added to that situation is the burden of defining the unique lease language if no guidance is set by the legislature. I urge the approval of this bill to provide assistance to small businesses that face a very difficult rent renegotiation in very unsettling times. The impact of this renegotiation on our employees and customers is considerable.

I respectfully request that you approve House Bill HB2284.

Aloha,

Connie Smales

Connie Smales, President

LATE TESTIMONY

BENDET FIDELL

EDWARD R. BENDET
JAY M. FIDELL
YURIKO J. SUGIMURA
THOMAS R. SYLVESTER*
KEITH S. AGENA
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February 1, 2010

Representative Angus L.K. McKelvey, Chair
Representative Isaac W. Choy, Vice-Chair
House Committee on Economic Revitalization, Business, & Military Affairs
State Capitol
Honolulu, Hawaii 96813

Re: HB 2284 Relating to Real Property – Testimony in Support
Hearing Date: Tuesday, February 2, 2010, 8:30 a.m., Room 312

Dear Representatives McKelvey, Choy and Members of the Committee:

My name is Jay Fidell. I am an attorney at law and counsel for Citizens for Fair Valuation ("CFV"), a nonprofit coalition of businesses with long-term ground leases in the Mapunapuna, Kalihi Kai and Sand Island areas.

I write in strong support of HB 2284, which seeks to extend the sunset date of Act 189 from June 30, 2010 to June 30, 2015. No other changes or amendments are contained in the bill.

With the passage of Act 189, Citizens for Fair Valuation had hoped that lessor, HRPT, would alter its business model such that open and transparent negotiations would lead to acceptable rents for both parties and that Act 189 would sunset as written.

Unfortunately, HRPT has instead chosen to continue its campaign to intimidate lessees through take-it-or-leave-it (TIOLI) offers that are twice the going market rate, demanding lease amendments to include terms favorable just to HRPT, and even going so far as to require lessees to waive their rights under Act 189, now and forever.

HRPT has bent every effort and stratagem to further leverage its oligarchic control of the land to force rates artificially higher than the actual rental

market. As the largest owner of commercial and industrial land in Oahu, HRPT apparently feels it is entitled to force lessees into astronomical rents without regard for its obligation under the lease to provide "fair and reasonable rents."

Should the parties fail to reach agreement through negotiation, the lease requires arbitration. This process is extremely expensive, time consuming and intimidating. Lessees need to hire attorneys, appoint an appraiser to sit on the panel, contract with experts to provide economic information, and appraisers to express their expert opinion as to the rent. This is like a trial and the costs can be in the hundreds of thousands. For the everyday small business owner in the area, arbitration is an economically terrifying process. It means having to confront the oligarchic landowner in an arena that is alien and unknown.

Even when a lessee is able to successfully bear the huge expense of arbitration to dispute HRPT's inflated rental demands, HRPT ignores that arbitration award and continues to make inflated rental demands on other lessees, forcing them to accept unreasonable TIOLI offers or go through the same expensive and intimidating arbitration process again. See the article about the Servco arbitration award in Pacific Business News on January 29, 2010, a copy of which is attached.

HB 2284 is needed to remind HRPT that its leases call for good faith negotiation of "fair and reasonable rents." HRPT seems to have deliberately chosen to ignore Act 189 and the spirit of its assurances to its lessees and the legislature over these past several months.

Act 189 does not change the terms of the existing leases. Act 189 does not set rents. Act 189 does not say rents should be below or above what is fair and reasonable to both the parties. Act 189 merely reminds HRPT of the terms of the contract and seeks rents that are fair and reasonable for both parties. It is not a measure that stops HRPT from raising rents, only from raising them beyond fair and reasonable. Clearly, that is exactly what HRPT would like to do, and what it is trying very hard to accomplish.

Commercial and industrial businesses have long been recognized as a fundamental part of a community's economic base and that those businesses are often the engine of economic growth within a community. In adopting Act 189, the Legislature was aware that "[t]he commercial and industrial properties that exist within the State's urban districts are primarily owned by a few landowners" and that the small businesses on these lands supply crucial goods and services to Honolulu businesses.

It is therefore appropriate and legitimate for the Legislature to extend Act 189 in order to reduce the likelihood that commercial and industrial operations serving Honolulu would have to reduce their workforces, raise consumer prices or worse, be forced to close their doors forever.

In the circumstances, I respectfully request that you pass out HB 2284 extending the sunset date of Act 189 to June 30, 2015.

Thank you for your consideration of my views in this matter.

Very truly yours,

Jay M. Fidell
Of BENDET FIDELL

JMF:dt